

December 2020

The Role of the ESP in Gazprom's European Sales Strategy

1. Introduction

In the two years since Gazprom Export launched its Electronic Sales Platform (ESP), the volumes sold on this platform have grown substantially, reaching levels comparable with total supplies to the European market offered by some of Gazprom's competitors. The range of products available on the ESP has widened to cover eleven destinations and delivery schedules from within-day and day-ahead to seasonal and gas year delivery. With substantial counterparty interest generated by these offerings – and reflected in the sales figures – the ESP has emerged as a key element in Gazprom's broader European sales strategy, complementing Gazprom's existing portfolio of long-term contracts (LTCs) and the activities of Gazprom's trading subsidiaries on a range of European hubs.

The past two years have been something of a rollercoaster ride for Gazprom, with the growth in European sales to record levels in 2018/19 contrasting sharply with the first three-quarters of 2020, when sales fell back to 2016 levels. As Gazprom rode that rollercoaster, the ESP first generated additional sales in a rising market, and then helped to maintain sales in a falling market as LTC nominations dropped and hub prices collapsed. As such, the strategic role of the ESP in adapting to those changing market conditions provides valuable insights into Gazprom's European sales strategy.

Therefore, this analysis of the ESP not only draws conclusions regarding the development and functioning of the ESP itself, but also provides a deeper and more nuanced understanding of the sales strategy of the single largest external supplier to the European gas market: Gazprom.

2. Context: The launch of the ESP

Drivers of change in Gazprom's European sales strategy

Gazprom traditionally sold its gas to its European counterparties under long-term, oil-indexed contracts, but over the past decade it has been forced to adapt to changes on the European market in the face of political and commercial developments.

The political drivers of changes in Gazprom's sales strategy were twofold: the first is the regulation-driven liberalisation of the European gas market that has occurred since the passage of the Third Gas Directive into EU law in 2009¹ and the second was the European Commission antimonopoly investigation into Gazprom's European sales practices, which ended with a negotiated settlement in May 2018. In accordance with that settlement, Gazprom committed to offering price reviews every two

¹ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC

years (and an additional ‘extraordinary’ review every five years) to Estonia, Latvia, Lithuania, Poland, and Bulgaria, should the prices in their contracts diverge substantially from prices on the continental European hubs.^{2,3} In a political and regulatory sense, these two drivers challenged the more rigid, ‘closed shop’ model of a small number of vertically-integrated suppliers and customers bound together by long-term contracts with oil-indexed pricing and limited flexibility. In its place emerged a market with a greater number of counterparties, less supplier control over downstream infrastructure, and pricing influenced by hubs even in less-competitive markets, such as those in the eastern half of the EU.⁴

The commercial drivers of change were also twofold. The first was the divergence of oil-indexed and hub gas prices in Europe in 2010-2014, which triggered a wave of arbitration cases and contractual renegotiations between the major suppliers and their counterparties. Even once the differential between oil-indexed and hub gas prices had narrowed again after 2014, the shift towards hub-indexation continued, especially in north-western and central Europe. The second commercial driver was the intensification of supply-side competition on the European market since late 2018, primarily due to the wave of LNG landing on European shores. Although Gazprom’s sales to Europe grew between 2015 and 2018, they faltered in the face of this competition in 2019, and then fell in 2020.

Taken together, these factors (European market liberalisation, differentials between hub and oil-indexed prices and related counterparty pushback, the antimonopoly investigation, and intensifying supply-side competition) prompted a three-part strategic response from Gazprom.

Gazprom’s three-pronged response: LTC pricing, trading, and the ESP

Part I: Shift in LTC pricing mechanisms

The first element of this response was a shift in Gazprom’s LTC pricing mechanisms. Having previously resolutely defended oil-indexation, Gazprom now reports that most of its sales to the European market are, in fact, hub-indexed. At its Investor Day in February 2020, Gazprom stated that, in Q1-3 2019, 56.7 per cent of its sales to Europe were hub-indexed, along with 15.5 per cent ‘quasi oil-indexed’ and 16.5 per cent oil-indexed. The remaining 11.3 per cent was sold via ‘Trading & ESP’.⁵ The International Gas Union (IGU) refers to hub-indexed supplies as ‘Gas-on-Gas’ (GOG) and oil-indexed supplies as ‘Oil Price Escalation’ (OPE). The IGU defines ‘quasi oil-indexed’ (also known as ‘hybrid’) as follows:

Oil indexation is partly maintained but within a price corridor set by hub prices. Such contracts are sometimes called quasi-oil indexed but could equally be referred to as quasi-hub indexed... such hybrid contracts are split between GOG and OPE, with the proportions dependent on how narrow the price corridor is. For example, if the price corridor is very narrow, the contract is effectively only notionally linked to oil prices and therefore would be allocated more towards GOG. In contrast if the band is relatively wide then more would be allocated to OPE.⁶

Therefore, the ‘quasi oil-indexed’ sales by Gazprom could be GOG or OPE in the IGU classification, depending on how wide or narrow the pricing corridor is. Interestingly, the relative shares of Gazprom’s oil and hub-indexed contracts in Q1-3 2019 align very closely with the geographical split between Gazprom’s sales to the western and eastern halves of the European market, as illustrated below.

² European Commission, 2018. Antitrust: Commission imposes binding obligations on Gazprom to enable free flow of gas at competitive prices in Central and Eastern European gas markets. *Press Release*, 24 May. https://ec.europa.eu/commission/presscorner/detail/en/IP_18_3921

³ European Commission, 2018. COMMISSION DECISION of 24.5.2018 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union (TFEU) and Article 54 of the EEA Agreement Case AT.39816 – Upstream Gas Supplies in Central and Eastern Europe. https://ec.europa.eu/competition/antitrust/cases/dec_docs/39816/39816_10148_3.pdf (For commitments on pricing, see page 34)

⁴ IGU, 2020. *Wholesale Gas Price Survey [2020 Edition]*. https://www.igu.org/app/uploads-wp/2020/07/IGU_WholesalePriceSurveyReport2020_01_07_20.pdf (see page 15)

⁵ Gazprom, 2020. *Investor Day Presentation*. <https://www.gazprom.com/f/posts/64/716836/investor-day-2020-presentation.pdf> (see page 27).

⁶ IGU, 2018. *Wholesale Gas Price Survey (2018 Edition)*. https://www.igu.org/app/uploads-wp/2018/07/IGU_Wholesale-Gas-Price-Survey-2018-DK3.pdf. See page 60, Box 2: Hybrid contracts in Europe.

Given Gazprom's European sales of 141.6 bcm in Q1-3 2019, the proportions stated by Gazprom equate to 80.3 bcm of hub-indexed sales, 21.9 bcm 'quasi oil-indexed', 23.4 bcm oil-indexed, and 16.0 bcm via trading and the ESP. This suggests that 45.3 bcm of Gazprom sales in Q1-3 2019 were either partially or completely oil-indexed, and by contrast, 96.3 bcm of sales were hub-indexed or sold through trading/ESP. The share of effectively 'hub-indexed' sales could be even higher, if a portion of quasi oil-indexed sales have a pricing corridor narrow enough to be classified as GOG by the IGU.

For comparison, Gazprom's sales in Q1-3 to Turkey, Finland, and a further eleven countries in central and south-eastern Europe⁷ totalled 48.8 bcm in the same period. Conversely, Gazprom's self-reported sales to nine countries in western Europe⁸ totalled 92.8 bcm in that period. It is likely that the oil-indexed and quasi oil-indexed sales were mostly to Turkey, Finland, central Europe, and south-eastern Europe, while the hub-indexed and trading/ESP sales were mostly to western Europe.

Taking into account the fact that 2.9 bcm was sold via the ESP for delivery to the Czech Republic, Slovakia, and Hungary in Q1-3 2019, the East-West split is very closely aligned, with a) 45-46 bcm of oil-indexed or quasi oil-indexed sales to Turkey, Finland, central Europe, and south-eastern Europe, b) 93 bcm of hub-indexed or trading/ESP sales to western Europe, and c) 3 bcm of ESP sales to central Europe. Furthermore, it is possible that a portion of Gazprom's quasi oil-indexed sales to central Europe have pricing corridors narrow enough to be effectively GOG. This is likely in the Czech Republic, Slovakia, and Hungary, where Gazprom was not obliged to make pricing commitments as part of the antimonopoly settlement.

Part II: Trading subsidiaries for sales optimisation

In addition to adjusting its LTC pricing, Gazprom pursued sales via its trading subsidiaries. In different parts of Europe, it is possible to find companies that were created as wholly-owned subsidiaries or joint ventures with local partners to manage Russian pipeline gas supplies under LTCs. Today, Gazprom Germania (which is wholly-owned by Gazprom Export) lists four such subsidiaries (Gazprom Schweiz, Wingas, WIEH, and Vemex) as vehicles for trading and sales optimisation in different parts of Europe: Gazprom Schweiz trades gas in Austria, Italy, Serbia, and the former Soviet Union; Wingas and WIEH primarily trade gas in Germany but Wingas is also active in Belgium, Austria, the Netherlands, the Czech Republic, and Slovakia; and Vemex operates in the Czech Republic and Slovakia.^{9 10}

Another Gazprom Germania subsidiary, the UK-based Gazprom Marketing & Trading Ltd (GM&T), was created with the explicit aim of developing a trading portfolio in north-western Europe. Between 2002 and 2006, GM&T began trading on hubs in the UK, Belgium, the Netherlands, and Germany.¹¹ Notably, the 'Global Gas, Power, and Derivatives' business unit of GM&T "is responsible for the trading activity of the Group with focus on hedging and optimisation of gas supplied by OOO Gazprom Export and its affiliates as well as optimisation of the Group's assets across Western Europe". GM&T is also active in sales to final consumers, through its Global Retail business unit. That unit "delivered 51,958 GWh of gas to end users in the UK and Ireland during 2019" (4.85 bcm), in addition to 16,706 GWh to France and 3,651 GWh to the Netherlands.¹² Taken together, the combined 72.3 TWh delivered to final consumers in north-western Europe equates to approximately 6.75 bcm.

The key points here are firstly that Gazprom Export had vehicles for gas trading and sales optimisation long before the launch of the ESP, and secondly that GM&T in particular has provided Gazprom with experience of hub-trading that has undoubtedly informed its operation of the ESP.

⁷ Poland, Hungary, Slovakia, Czech Republic, Romania, Bulgaria, Serbia, Croatia, Slovenia, Bosnia & Herzegovina, and North Macedonia

⁸ Germany, France, Italy, United Kingdom, Austria, Netherlands, Switzerland, Belgium, and Denmark

⁹ Gazprom Germania, 2020. *Corporate Structure*. <https://www.gazprom-germania.de/en/company/structure.html>

¹⁰ Gazprom Germania, 2020. *Gas trading*. <https://www.gazprom-germania.de/en/business-areas/natural-gas-trading.html>

¹¹ Gazprom Marketing & Trading, 2020. *Our History*. <http://www.gazprom-mt.com/WhoWeAre/OurHistory/Pages/default.aspx>

¹² Gazprom Marketing & Trading, 2020. *2019 Strategic Report with Supplementary Financial Information*. <http://www.gazprom-mt.com/WhatWeSay/Lists/PublicationsList/2019%20Strategic%20Report%20with%20Supplementary%20Financial%20Information.pdf> (see page 1)

Part III: Auction-based sales and the Electronic Sales Platform

The third part of Gazprom's response to changes on the European market was to experiment with auction-based sales, away from the established European hubs. Gazprom Export conducted three such auctions between September 2015 and September 2016. Two of these auctions were specifically for the sale of gas to Germany, while the third (in March 2016) was for the sale of gas to the Baltic states.

However, these auctions had arguably different aims to their successor, the ESP. The Baltic auction coincided with the expiry of Gazprom Export's LTC with the Lithuanian Lietuvos Dujų Tiekimas (LDT), and was an attempt to maintain sales in the context of LDT's reluctance to sign a new LTC. The fact that the Baltic auction was not repeated suggested limited regional demand for Russian pipeline gas beyond Gazprom Export's supplies to Latvijas Gāze under an LTC that does not expire until 2030.¹³ The auctions for sales to Germany may also have had aims other than simply generating sales revenues. Specifically, the auction held in September 2016 – at which no gas was sold for delivery via the OPAL pipeline to southern Germany – took place just one month before the European Commission offered a ruling on how much capacity Gazprom was allowed to book on that pipeline.¹⁴

The pricing context also differed substantially between the auctions in 2015-16 and the launch of the ESP in September 2018. The final auction in September 2016 was held when day-ahead gas prices at Gaspool (10.72 EUR/MWh) had just reached their lowest point since December 2009. However, European hub prices then grew strongly over the following two years; just four days after the first ESP sales transaction, the day-ahead price at Gaspool peaked at 29.60 EUR/MWh - the second-highest since April 2013.¹⁵ While the 2015-16 auctions may have had various motives, the prevailing price dynamics in 2018 suggest that the ESP was launched to take advantage of a rising market.

Conclusions regarding the launch of the ESP

The launch of the ESP in September 2018 took place at a time when European gas prices had been growing steadily for over two years, but the supply-side competition from LNG was beginning to intensify and Gazprom was going through the process of adapting to both the shift to hub-pricing and the antimonopoly settlement. The short-term indicators (rising European prices and Gazprom's own growing export volumes in 2016-18) suggested that the ESP could be a useful means of generating additional sales revenues for Gazprom: The sales were there to be captured. However, the longer-term indicators were that the European market was becoming more competitive and that the ESP could offer an alternative means of generating sales beyond long-term contracts and sales optimisation via subsidiaries such as GM&T.

In other words, the ESP was launched at a watershed moment for Gazprom. The period of rising prices and export volumes was coming to an end, and a period of more intense supply-side competition was just beginning. In theory, the ESP could capture additional windfall sales in a rising market, while in falling market it could offer another means of competing. However, given that these aims could arguably have been achieved by hub trading via GM&T, this begs the question: what is the role of the ESP in Gazprom's broader sales strategy, and what benefits does Gazprom accrue from the ESP beyond those that could be obtained via its existing trading subsidiaries? This question is answered with regard to major indicators of the ESP performance: 1) monthly sales volumes; 2) variations in counterparty demand for the different products offered; 3) sales volumes to different delivery destinations and via different delivery routes; and 4) the prices achieved for sales via the ESP.

¹³ Gazprom, 2010. Alexey Miller holds talks with Latvian Economy Minister Artis Kampars. *Press Release*, 21 December. <https://www.gazprom.com/press/news/2010/december/article106925/>

¹⁴ For more detail on capacity bookings on the OPAL pipeline, please see other papers published by OIES on this subject, including: Yafimava, K., 2017. The OPAL Exemption Decision. *Oxford Energy Insight 18*, September. <https://www.oxfordenergy.org/publications/opal-exemption-decision-comment-cjeus-ruling-reject-suspension/>

¹⁵ The highest being the one-day spike during the 'Beast from the East' spell of cold weather in February-March 2018

What is the Electronic Sales Platform?

The ESP is an auction platform. Gazprom Export offers volumes at a reserve price, stipulating delivery destinations and delivery periods (for example, day-ahead, month-ahead, winter 2021/22). The volume of gas sold is measured in kilowatt hours (kWh) and priced in Euros (EUR). To purchase gas on the ESP, the counterparty must follow the prequalification procedure and become a registered 'Bidder'. Once they are registered, the Bidders (or their authorised 'Traders') may participate in sales sessions, conducted as auctions. The highest bidder gets the volume offered, and if the two highest bids are equal, the volume is allocated on a 'first come, first served' basis.

The General Terms and Conditions (GT&Cs) document for the ESP states: "Reserve prices and the quantity of offered gas are confidential and shall not be communicated to third parties before, during or after sales sessions". Furthermore, the GT&Cs state that when Gazprom Export evaluates the bids once the sales session has ended, it is not "obliged to disclose or prove the allocation method to traders". From this it is possible to conclude that the traders are aware only of the reserve price, their own bid, and whether or not they were successful with that bid. It is possible that they do not find out the price of the successful bid, as they would on a trading hub.

The volumes purchased on the ESP are delivered on a flat profile, with an equal daily volume throughout the delivery period, and at a flat hourly rate throughout each of those days. Specifically, the ESP Sales Agreement, which is completed by both Gazprom Export and the successful bidder once a sales session has concluded, states: "For each Day of the Delivery Period, the DCQ [Daily Contract Quantity] shall be equal to [_] kWh... For the avoidance of doubt, the DCQ shall be delivered and offtaken at a flat hourly profile".

Therefore, the ESP is similar to a hub in terms of the flat profile of physical deliveries, but with the crucial difference that Gazprom Export's counterparties are limited in the amount of information they are able to glean about their competitors (and Gazprom Export) from the operation of the ESP.

See: Gazprom Export, 2020. «5. General Terms and Conditions (updated)» 03.12.2019 and «6. a) Gas Sales Agreement (updated)» 03.12.2019. <http://www.gazpromexport.ru/en/esp/documents/>

3. Sales volumes

The basic indicator of the success of the ESP is the volume of monthly sales, contextualised by their equivalent share of Gazprom's total European sales. Between the first ESP sale on 20 September 2018 and 30 November 2020, Gazprom Export sold 42.9 bcm via the ESP. Of that figure, 12.9 bcm was sold in the gas year¹⁶ 2018-19 and 27.8 bcm was sold in the gas year 2019-20, followed by 2.1 bcm in October-November 2020. For context, this means that in the gas year 2019-20, Gazprom Export sold more gas to Europe via the ESP alone than arrived in Europe via pipeline from North Africa in the same period (22.9 bcm) and the same volume as arrived in Europe in the form of LNG from the US (the second-largest supplier of LNG to Europe after Qatar).¹⁷

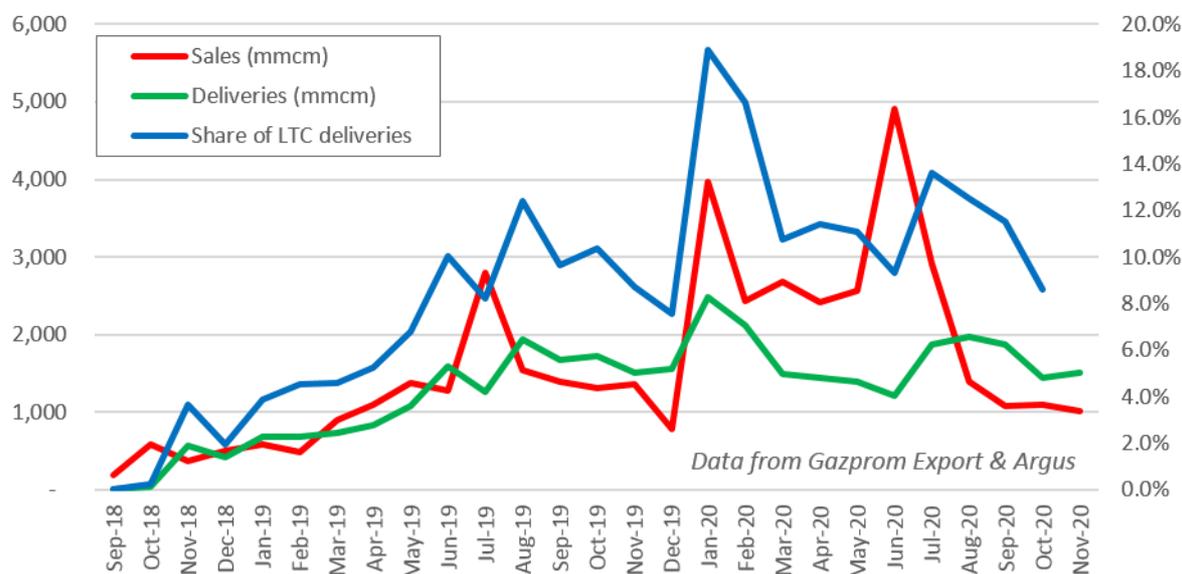
Total monthly sales on the ESP exhibited a general ongoing trend of growth from the launch in late September 2018 until July 2020. Within that period, three notable peaks (July 2019, January 2020, and June 2020) were observed, along with one significant trough (December 2019). Since then, sales in the period from August to November 2020 have fallen back to levels slightly below those of 12 months earlier. The extent to which ESP sales have been sustained is illustrated by the fact that, in the period between April 2019 and November 2020, monthly sales fell below 1 bcm just once (in December 2019).

¹⁶ From 1 October to the following 30 September

¹⁷ Data sourced from ENTSOG Transparency Platform for pipeline flows and Platts LNG for LNG imports

As the total monthly sales grew between September 2018 and July 2020, the equivalent share of ESP sales in Gazprom's total European sales also grew. Between June 2019 and October 2020, they remained within a corridor of 7-14 per cent equivalent of Gazprom's total European sales, with the exception of the spike in Jan-Feb 2020. From mid-2019 onwards, ESP sales were substantial compared to both Gazprom's total European sales and European imports from other sources.

Figure 1: ESP sales and deliveries by month (mmcm/month) and equivalent share of Gazprom's total European sales (%)



Source: Data from Gazprom Export and Argus, graph by the author

In Figure 1, the difference between sales and deliveries is based on the range of products that Gazprom now offers at the ESP. While the sales figures refer to completed transactions, the delivery figures are calculated based on the products that have been sold. So, for example, a parcel of 10 mmcm sold in mid-January 2020 as a day-ahead product is counted as a January sale and a January delivery. Conversely, a parcel of 10 mmcm sold in mid-January as a month-2 delivery product is counted as a January sale and a March delivery. Where sales are higher than deliveries in a given month, this will indicate deliveries in later months, even if sales transactions decline. If this trend is exhibited across several consecutive months, it is a sign of future growth - each month creates a greater and greater 'build-up' of volumes that have been sold but have yet to be delivered. By contrast, several consecutive months of monthly sales volumes lower than monthly delivery volumes is a sign of a likely decline in delivery volumes in the near future, as the volume sold but not yet delivered shrinks.

Until November 2019, sales and deliveries were closely aligned, while the spike in sales in July 2019 led to deliveries slightly above sales for the rest of 2019. By contrast, sales were substantially higher than deliveries from January to July 2020. This trend was a sign of Gazprom Export 'forward selling' by concluding sales for delivery further and further into the future on the basis of the range of products available on the ESP, as discussed below.

By contrast, between August and November 2020, monthly deliveries were 400-800 mmcm higher than sales, meaning that the 'build-up' of volumes that had been sold but not yet delivered, declined. As of the 1 December 2020, a total of 42.9 bcm has been sold and 35.1 bcm has been delivered. Of the 7.8 bcm that has yet to be delivered, 4.5 bcm is earmarked for delivery between December 2020 and March 2021 (inclusive), a further 3.2 bcm between April and December 2021, and the remaining 170 mmcm in 2022. So even if prompt and BoM sales are limited in Q1 2021, deliveries of gas sold via the ESP will continue to be above 1 bcm per month, as they have been since May 2019. If the November sales provide guidance, with prompt sales returning and totalling 222 mmcm, then monthly deliveries in Q1 2021 are likely to be even higher, supported by winter prompt sales.

4. Products available via the ESP

When the ESP was launched, volumes were available only for delivery in the following month (month-ahead¹⁸), or for delivery two or three months ahead.¹⁹ The first day-ahead transaction was concluded in December 2018, although day-ahead sales only began to account for a significant share of total sales from the second half of January 2019 onwards. The first transaction for delivery within the same month (Balance of Month, or BoM) was concluded in January 2019, along with the first transactions for 'Weekend' delivery. The first sales for delivery by quarter were concluded in April 2019, for delivery in Q3 and Q4 2019. In order to estimate deliveries in each calendar month, it is assumed that volumes sold for delivery in a specific quarter are spread equally across the three months of that quarter.

In December 2019, Gazprom Export began offering within-day and seasonal products (for delivery in 'Summer 2020'). The first sale for delivery in 'Winter 2020/21' was concluded in March 2020. From late June 2020, volumes were sold for delivery in 'Summer 2021'. Also in June 2020, a single transaction was concluded for delivery of 8 mmcm to Slovakia VTP in 'Summer 2022'. As with the quarterly products, the estimates for delivered volumes assume that seasonal products are spread equally throughout the six months of the season: October to March (winter) and April to September (summer).

From March 2020 onwards, transactions were concluded for delivery in the calendar year 2021. Those sales continued throughout the summer, but no such transactions were concluded in September, October or November. From May 2020 onwards, a small number of transactions were concluded for delivery in the calendar year 2022. Again, the estimates for ESP deliveries in a calendar year are assumed to be spread equally across the twelve months of that calendar year.

Finally, in June 2020, two large sales transactions (totalling 1,095 mmcm) were concluded for delivery to the Bereg VIP in the gas year 2020/21 – the only such transactions for delivery across a gas year. These transactions, which took place on the 23 and 25 June, were accompanied by an announcement by the Hungarian Foreign minister, Peter Stijjarto, that Hungary would purchase 2 bcm for injection into storage in summer 2020 and a further 4.2 bcm in the gas year 2020/21, while engaging in talks over a "flexible, long-term gas supply agreement" for up to 6 bcm per year once the connection to Turkish Stream is launched in October 2021.²⁰ This 1,095 mmcm purchase, which contributed to the spike in ESP sales in June 2020 (illustrated in Figure 1), should therefore be seen as a 'one-off' event, rather than the start of the regular purchase of such volumes for delivery to the Hungarian market.

As Figure 2 illustrates, between February 2019 and February 2020, ESP sales were relatively evenly divided between prompt (within-day, day-ahead, and weekend) and BoM sales on the one hand, and sales for month-ahead (month-1) and month-2/3 on the other, with limited sales volumes for delivery under other schedules. However, from March 2020 onwards, the vast majority of ESP sales were for other delivery schedules: by quarter, season, gas year, or calendar year.

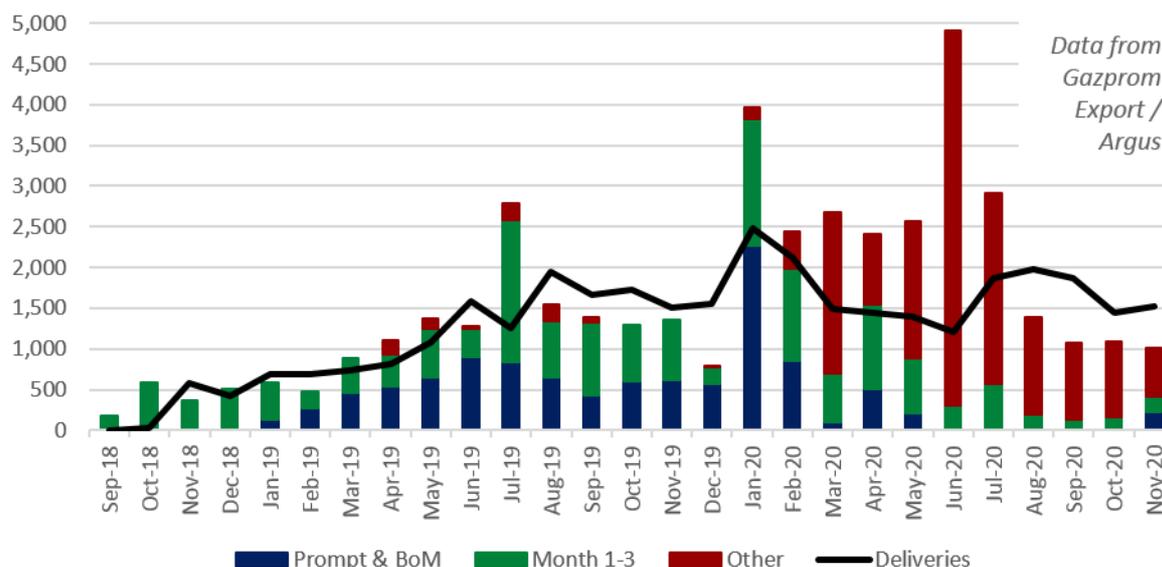
There are several explanations for this trend, and it is possible that all were at play. Firstly, Gazprom Export may have reduced the volume of prompt products on offer at the ESP as European hub prices slumped through the summer, either because Gazprom Export itself did not wish to contribute to the oversupply that was driving down prices or, potentially, because European hub prices were reaching such low levels that they were not sufficient to cover the cost of production, delivery, and Russian export duty (in other words, they were potentially cash negative). This cannot be proven, because Gazprom Export does not publish the volumes offered on the ESP, only the volumes sold. Secondly, Gazprom Export's European counterparties were themselves supply-long in Q2-3 2020, and most likely had little need for additional volumes via the ESP. Thirdly, from a strategic point of view, 'forward selling' by predominantly offering products with delivery dates further into the future may have enabled Gazprom Export to sustain its ESP monthly sales volumes without engaging in a price war at a time when European hub prices were already at historical lows.

¹⁸ Argus refers to this as 'Month-1' in its pricing data

¹⁹ Argus refers to these as 'Month-2' and 'Month-3' in its pricing data

²⁰ Reuters, 2020. Hungary agrees gas deal with Gazprom, views long-term agreement. *Reuters*, 24 June.

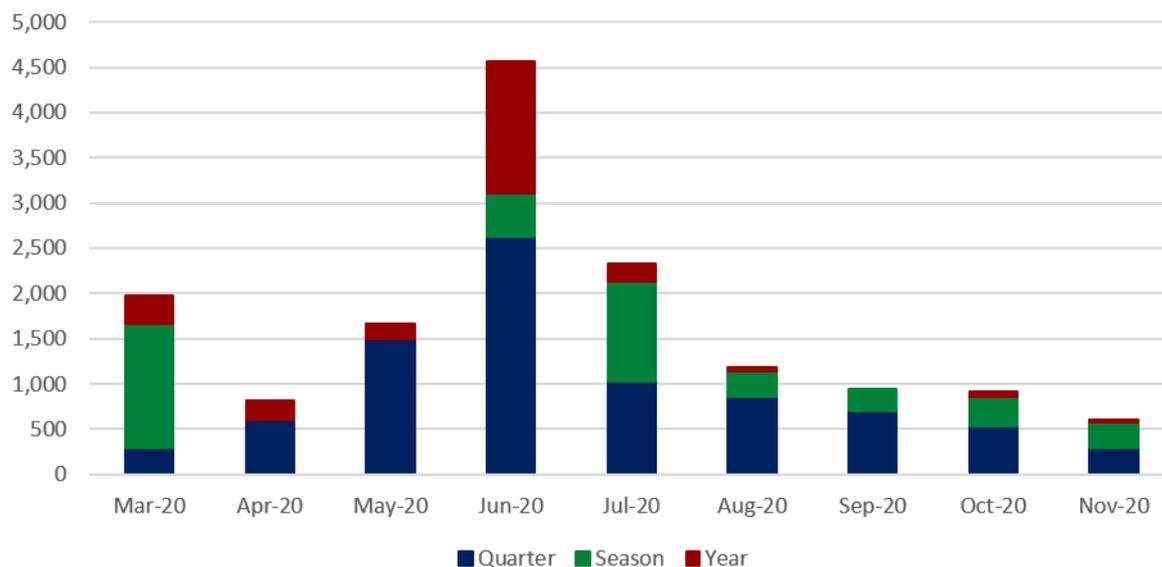
Figure 2: ESP sales by delivery schedule and estimated deliveries (mmcm/month)



Source: Data from Gazprom Export and Argus, graph by the author

When the 'Other' sales from Figure 2 are broken down and illustrated in Figure 3 (below), it is clear that most of these sales were for delivery in a specific quarter. In April, May, and June such sales were mostly for delivery in Q3 2020, in June, July, and August sales were mostly for delivery in Q4 2020, and in August, September, and October sales were mostly for delivery in Q1 2021. The notable exceptions were the seasonal sales for delivery in Summer 2020 (March) and Winter 2020/21 (July), and the 'year' sales for delivery in gas year 2020/21 (June).

Figure 3: ESP sales in 2020 by delivery schedule (mmcm/month)



Source: Data from Gazprom Export and Argus, graph by the author

A key point of comparison between Gazprom's LTC and ESP sales is the issue of counterparty flexibility. From the customer perspective, a major benefit of having an LTC is the flexibility of daily nominations and annual offtake within the 'take-or-pay' boundaries stipulated by the contract. For the supplier, this necessitates the retention of operational flexibility to meet fluctuating customer nominations. For the supplier and customer, the costs and benefits may be accounted for by price

premiums relative to spot or flat-rate purchases. By contrast, the sales agreement for purchases on the ESP stipulate that volumes are provided at a flat daily rate, with a flat hourly profile.

From Gazprom's perspective, it is this certainty of delivery profiles throughout delivery periods - whether those delivery periods are single days, 90-day quarters, or even a full gas year or calendar year - which enables it to use the ESP to optimise its gas transportation capacity. The flat delivery profile provides a period of certainty when quarterly, seasonal, or yearly products are sold: Gazprom does not have to account for fluctuations in nominations as with LTC deliveries.

By contrast, the prompt and month-ahead sales provide opportunities for fine-tuning capacity utilisation. If counterparty LTC nominations cause capacity utilisation to drop on a particular export route, Gazprom can place prompt volumes on the ESP at a price that is cash-positive while being competitive with hubs that serve that destination, and be confident of generating additional sales. Conversely, when utilisation rates move towards maximum capacity, Gazprom can reduce the prompt volumes it offers on the ESP.

For example, despite the generally supply-long character of the gas market in north-western Europe in 2019-20, the volume of ESP sales to that region undoubtedly contributed to Gazprom maintaining its two main supply routes to that region (Nord Stream and the Yamal-Europe pipeline) at full operating capacity through most of 2019 and again since mid-August 2020.

This helps to explain why Gazprom Export has managed to sustain its monthly ESP sales at over 1 bcm per month in 2020 even as counterparty demand for near-term products fell dramatically. This ability to 'lock in' sales via the ESP in a supply-long market represents the flip-side to the ability of the ESP to sell at least 425 mmcm/month of prompt and BoM products from March 2019 to February 2020, in the context of strong counterparty demand. In other words, the ESP did indeed capture windfall sales in a rising market between March 2019 and February 2020, and then offered an alternative means of generating (non-prompt) sales in a falling market thereafter.

The key conclusion in terms of product offerings and sales is that the ESP has enabled Gazprom to tailor its offerings to market conditions in a more proactive manner than via its LTCs, and in a more controlled manner than via its trading subsidiaries acting on European hubs. With regard to the LTCs, Gazprom is passive in acceding to nominations by its counterparties, while its trading subsidiaries effectively broadcast the volumes and prices it is prepared to offer to the broader market when they place volumes on hubs. By contrast, as explained in the box earlier, the ESP could be characterised as a 'closed shop', with the volumes offered and prices accepted seen only by Gazprom Export and the registered ESP bidders.

5. Delivery destinations

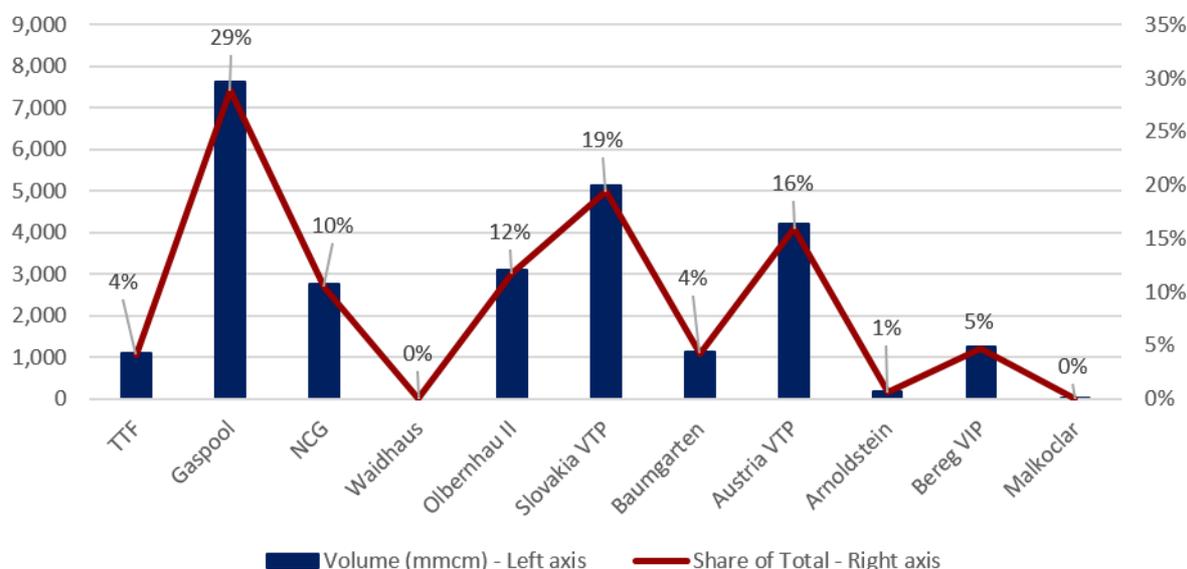
Since the launch of the ESP in September 2018, sales have been concluded for delivery to eleven different destinations: TTF, Gaspool, NCG, Olbernhau II (on the German-Czech border, for the Czech market), Waidhaus (on the Czech-German border, for the German market), Slovakia VTP, Austria VTP, Baumgarten, Arnoldstein (on the Austria-Italy border, for the Italian market), and Beregovo/Bereg VIP (on the Ukraine-Hungary border, for the Hungarian market). However, the last transaction for delivery to Waidhaus was concluded in November 2018, so it is assumed that either Gazprom Export no longer offers delivery to that point or Gazprom Export's counterparties are no longer interested in receiving gas at that point, perhaps favouring deliveries to the NCG market area. In November 2020, the first sales transaction was concluded for delivery to Malkoclar, on the Turkey-Bulgaria border.

Here it is worth remembering that the price of volumes sold for delivery to hubs (in this case, TTF, Gaspool, NCG, Slovakia VTP, and Austria VTP) include the cost of entry to that market area. By contrast, the price of volumes sold for delivery to border points (in this case, Olbernhau, Waidhaus, Baumgarten, Arnoldstein, and Beregovo/Bereg) do not, and so require the buyer to purchase capacity to enter the market area. This is likely to be a factor in both buyers' choices of products and the relationship between ESP and hub prices.

The mixture of hub and border point delivery destinations offered at the ESP may at least be partly explained by the fact that the border points at which delivery is offered are – in the case of Olbernhau, Waidhaus, Baumgarten, Arnoldstein – long-standing delivery points for Soviet/Russian gas exports to Europe: Olbernhau and Waidhaus to Germany, Baumgarten to Austria, and Arnoldstein to Italy. By contrast, several of the hubs offered (TTF, Gaspool, and NCG) are served via the more recent Yamal-Europe and Nord Stream pipelines (and onward connections in the form of OPAL in Germany and Gazelle in the Czech Republic).

As Figure 4 illustrates, Gaspool is the single largest destination for ESP sales. When sales to NCG are added, Germany alone accounted for 40 per cent of ESP sales in Jan - Nov 2020. Sales to central Europe (Czech Republic, Slovakia, and Austria) were also robust, accounting for 51 per cent of the total over the same time period. Conversely, sales to TTF and Italy (the latter at Arnoldstein on the Austria-Italy border) were limited. From this information, it is possible to conclude that Gazprom Export achieved only limited success in generating ESP sales to markets that also had easy access to LNG. Indeed, 95 per cent of ESP sales in Jan - Nov 2020 were to markets without access to LNG and where Gazprom Export already had a substantial presence in the form of LTCs.

Figure 4: ESP sales from Jan - Nov 2020 by delivery destination (mmcm) and share of total (%)

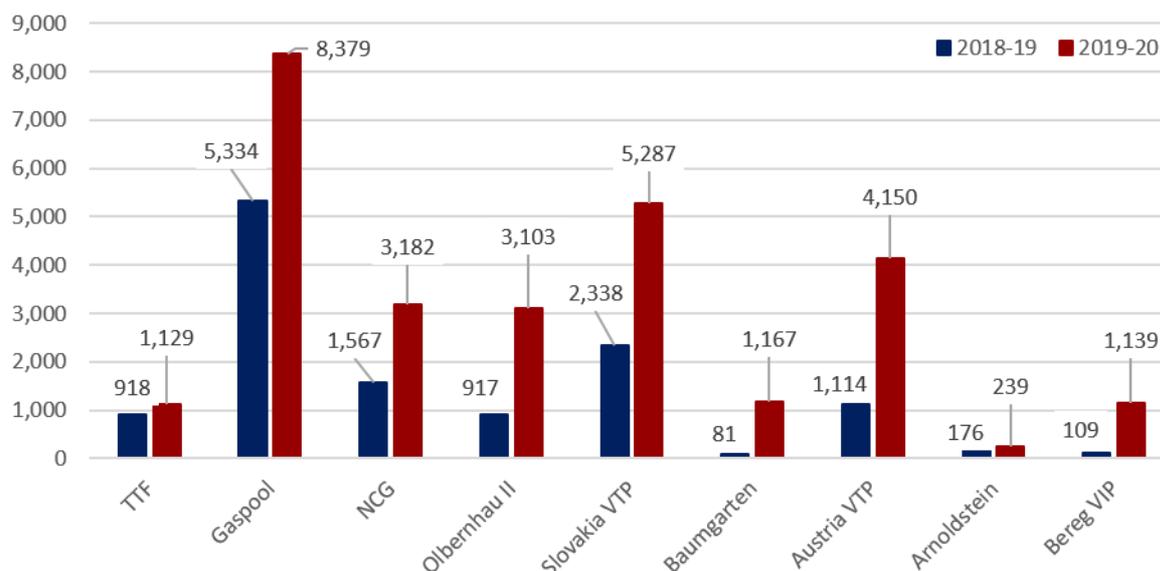


Source: Data from Gazprom Export and Argus, graph by the author

The ESP sales are largely concentrated on the markets of Germany, Austria, the Czech Republic, and Slovakia, where the Gazprom Export trading subsidiaries, Wingas, WIEH, Gazprom Schweiz, and Vemex are active, but the local hubs have only limited liquidity. By contrast, Gazprom Export has sold relatively limited volumes to those markets in north-western Europe where GM&T is most active and the regional hubs are more liquid (UK, France, Belgium, and the Netherlands). This suggests that the ESP offers a means of purchasing short-term volumes that is attractive to counterparties where hubs are less liquid, but is less attractive to counterparties with access to liquid hubs and/or LNG supplies.

Finally, as Figure 5 illustrates, it is interesting to note that the growth in ESP sales between the gas year 2018-19 and gas year 2019-20 was concentrated in markets where the ESP had initially found success. Sales to Germany (Gaspool & NCG), Austria (Baumgarten & Austria VTP), Czech Republic (Olbernhau II), and Slovakia each grew by between 2.2 and 4.7 bcm. By contrast, the destinations that did not see any notable increase were TTF and Arnoldstein (Italy), where the ESP sales were competing with LNG supplies. The same applies to Bereg VIP (Hungary), if the one-off purchase of 1,095 mmcm in June 2020 (as a 'bridge' to the next LTC), is discounted.

Figure 5: ESP sales by delivery destination in gas year 2018-19 and 2019-20 (mmcm)



Source: Data from Gazprom Export and Argus, graph by the author

6. Delivery routes

One of the benefits of the ESP for Gazprom Export is that it can offer the volumes it needs to keep its export routes flowing at close to full capacity. For example, Gazprom Export has an interest in keeping Nord Stream operating at full capacity, and if LTC nominations for deliveries via Nord Stream begin to fall, then it can simply place volumes for prompt delivery to Gaspool on the ESP at a discount to its LTC prices, in the hope of generating additional sales and thus maintaining the flows via Nord Stream.

With this in mind, it is worth considering the likely delivery routes for volumes sold on the ESP. As Figure 6 (below) illustrates, volumes for Gaspool and TTF are highly likely to be delivered via Nord Stream or the Yamal-Europe pipeline (via Belarus and Poland). The flows on the German-Czech border at Olbernhau and Waidhaus (which are connected by the Gazelle pipeline in the Czech Republic) suggests that volumes sold for these destinations (and, by extension NCG) are highly likely to be delivered via Nord Stream or Yamal-Europe, and then south to Olbernhau via the OPAL or EUGAL pipelines. By contrast, volumes sold for delivery to Bereg VIP, Slovakia VTP, Baumgarten, Austria VTP, and Arnoldstein are most likely made via Ukraine, with some allowance for cross-border movements between Austria and Germany. The key indicator here is the fact that, since 2018, very limited volumes have flowed from east to west across the Slovak-Czech border and across the Austrian-German border. This means that only small volumes are reaching Germany via Ukraine, Slovakia and either the Czech Republic or Austria.

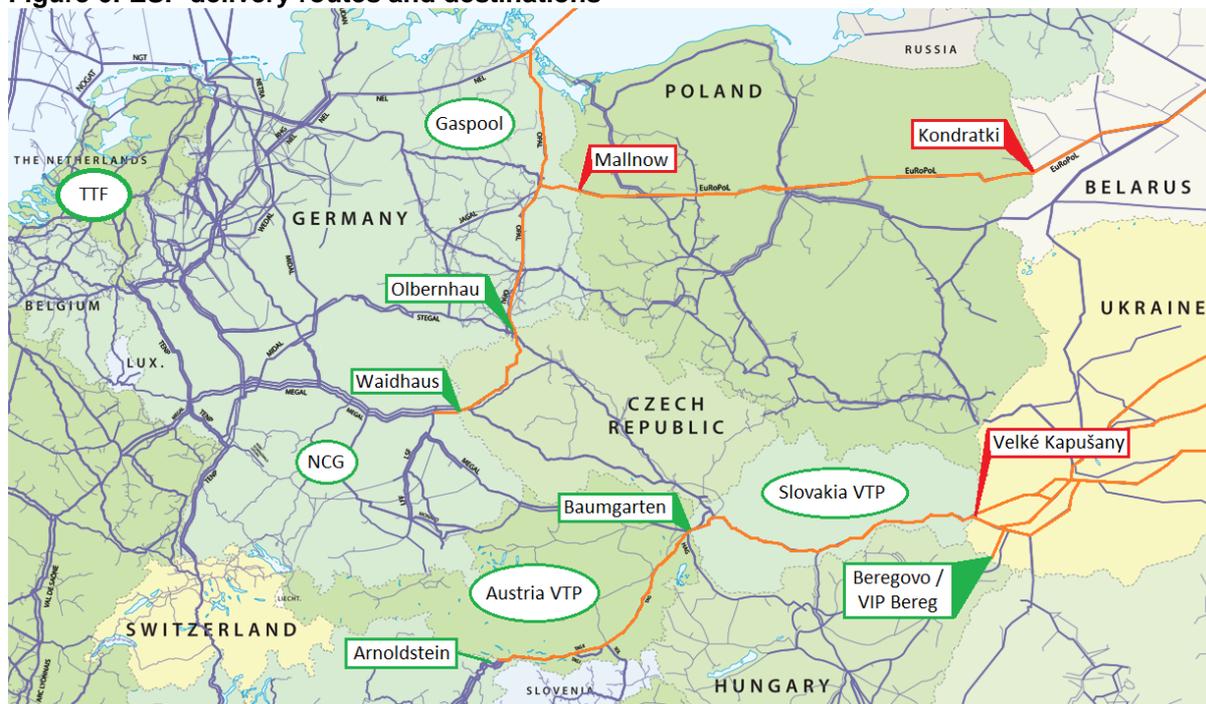
Taken together, ESP sales that are likely delivered via Nord Stream and Yamal-Europe accounted for 55 per cent of total ESP sales in Jan - Nov 2020, while sales that are likely delivered via Ukraine accounted for 45 percent. On the non-Ukrainian route, while Gazprom is expected to pursue a strategy of maintaining maximum flows via Nord Stream, it has new-found flexibility on the Yamal-Europe route via Belarus (where Gazprom owns the national transmission system) and Poland to Germany.

Since the expiry of the long-term contract for transit via Poland in May 2020, Gazprom is now only obliged to book the capacity that it needs. According to the ENTSOG Transparency Platform, firm capacity bookings at Kondratki (Belarus-Poland border) from 1 August to 30 November 2020 have been 1,027 GWh/d (around 96 mmcm/d), which is equal to the firm technical capacity. Data from the same

source states that physical flows at this point were around 1,020-1,025 GWh/d (95-96 mmcm/d) on almost every day from 7 August 2020 to 30 November.²¹

Most of that firm capacity at Kondratki (817 GWh/d, or 77 mmcm/d) was booked on an annual basis, starting from 1 October 2020. The remainder has been booked either monthly or even shorter-term.²² This suggests that, as long as the annually-booked capacity is utilised, Gazprom can flex its shorter-term capacity bookings to suit both its LTC nominations from counterparties in north-western Europe and its ESP sales to that region.

Figure 6: ESP delivery routes and destinations



Source: Original map from ENTSOG Transparency Platform, additions by the author

Key: Green Circle – hub ESP delivery destination; Green Rectangle – border point ESP delivery destination; Red Rectangle – major border point not offered as ESP delivery destination; Orange lines – likely delivery routes to ESP delivery destinations

Further south, Gazprom currently delivers gas via Ukraine in accordance with a five-year transit contract that entered into force on 1 January 2020. For 2020, Gazprom pre-paid for 178 mmcm/d of transit capacity (equivalent to 65 bcm/year), which will fall to 109 mmcm/d (40 bcm/year) for the period 1 January 2021 to 31 December 2024. These capacity bookings pertain to all entries into Ukraine from Russia, and all exit points combined. Unutilised daily capacity cannot be ‘carried over’. If Gazprom requires any additional capacity beyond those daily figures, it is entitled to book that capacity on a quarterly, monthly, or daily basis, but must pay higher tariffs.

Therefore, the question arises as to whether Gazprom Export will scale back its ESP offerings for delivery to destination points that require Ukrainian transit from 1 January 2021 onwards. The answer will depend on both LTC nominations by Gazprom Export’s counterparties and whether the sales prices on the ESP are sufficient to cover the cost of production, export duty, and transportation via Ukraine, if that transportation requires the payment of a higher transit tariff.

²¹ ENTSOG, 2020. *Transparency Platform*. <https://transparency.entsog.eu/#/map>

²² Gaz-System, 2020. *Auction results*. <https://en.gaz-system.pl/auctions/auctions-results/>

Here it is worth remembering that the pressure on Gazprom Export's pre-booked capacity via Ukraine will ease from the start of October 2021, when the onward connections to the Turkish Stream pipeline are expected to reach Hungary, with the launch of the interconnection on the Serbia-Hungary border. This will re-direct volumes that are currently being delivered to Hungary via Ukraine. The same will apply to volumes currently being delivered via Ukraine and Hungary to Serbia.

Finally, the potential for additional ESP sales to north-western Europe in the context of the relatively full usage of existing export capacity will undoubtedly be influenced by the question of if/when Nord Stream 2 will be completed, and to what extent it will be able to operate at full capacity. On 11 December, construction work restarted on the 16.5 km stretch in the shallow waters of Germany's Exclusive Economic Zone, but work on the 127 km stretch in the deeper waters around the Danish island of Bornholm. On the same day, the US Senate passed a Defence Department spending bill that includes Nord Stream 2 sanctions, which cleared the House of Representatives three days earlier.²³ Until such time as Nord Stream 2 is launched, this will place a cap on the volumes that Gazprom Export will be able to offer to north-western Europe via the ESP.

7. Prices: The ESP Index relative to Gazprom's LTCs and European hubs

Gazprom Export publishes the weighted average price of its total sales via the ESP every month. This indicator is referred to as the ESP GazEx Index (shortened here to 'ESP index'). Gazprom Export does not provide a breakdown of prices for different products or delivery destinations.

Since January 2019, the ESP Index has been at a discount to Gazprom's self-reported average European sales price,²⁴ although those two indices briefly converged in December 2019 and June 2020. Part of the reason for this differential is that the ESP Index reflects sales to a select group of European markets, and has tended to track the hub prices on those markets. By contrast, Gazprom's European average LTC sales price covers sales to *all* European markets, including those of Turkey and south-eastern Europe, where the oil-indexed or quasi oil-indexed prices may be higher. Another reason for the LTC premium (as mentioned earlier) is the built-in flexibility of LTC deliveries from the consumer perspective, which allows fluctuations in daily nominations that are not possible with the flat-profile deliveries of volumes purchased on the ESP, in addition to the flexibility of take-or-pay levels relative to the nominal annual contractual quantity of long-term contracts.

Interestingly, not only has the ESP index been at a discount to Gazprom's European average LTC sales for almost two years, but the majority of ESP sales have been to those destinations where Gazprom already holds substantial long-term contracts. If Gazprom Export's counterparties from a particular market area start to consistently reduce their LTC nominations in favour of picking up discounted volumes of the ESP, this could be an incentive for Gazprom Export to place a cap on volumes offered for delivery to that market area, which could cap overall ESP sales to a certain extent.

However, the extent to which Gazprom Export's counterparties are able to play off their LTCs against volumes available on the ESP is limited by the timeframes for submitting nominations and the costs and complexities of booking and re-booking gas transportation capacity from the delivery destination (hub or border point) to the final consumer in line with ESP purchases. On an annual basis, the take-or-pay levels of long-term contracts place a limit on the extent to which counterparties may forego LTC supplies in favour of ESP purchases in a given gas year or calendar year.

Aside from comparing the ESP Index to Gazprom's LTC prices, the other significant comparison is between the ESP Index and hub prices on the markets to which most ESP sales are delivered. In terms of establishing a 'like-for-like' comparison of similar products, Figure 2 shows that from Feb 2019 - Jan 2020, sales on the ESP were fairly evenly divided between prompt/BoM and month-1/2/3, while most of the latter were month-ahead (month-1). Therefore, during this period, the most appropriate

²³ Gugarats, H., 2020. US Congress votes to sanction Nord Stream 2. *Argus News & Analysis*, 11 December.

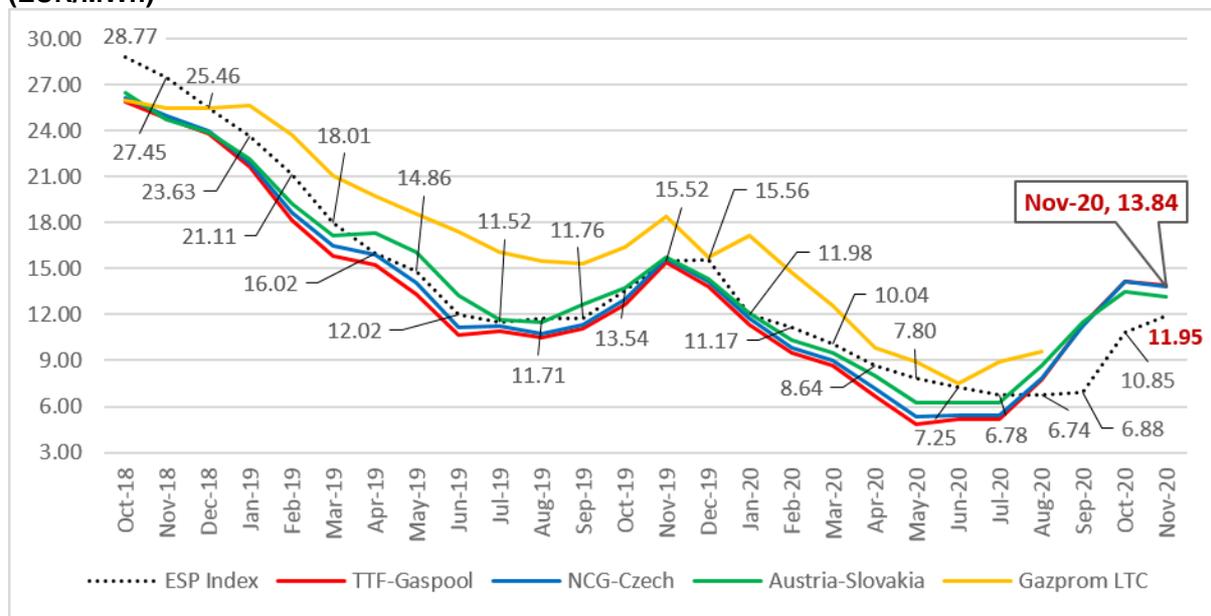
²⁴ Published by Argus



comparison is between the ESP Index and the average of the day-ahead and month-ahead prices for each European hub. Furthermore, the price spreads between 1) TTF and Gaspool, 2) NCG and Czech VTP, and 3) the Austria and Slovakia VTPs were very narrow, so it is reasonable to pair these off, using an average of the two for each pair.

The comparison between the ESP Index and the average of day-ahead and month-ahead prices for each of the three pairs of European hubs is illustrated in Figure 7. In Apr 2019 - Jan 2020, the ESP Index remained closely aligned to these European hub indices, in a corridor between TTF-Gaspool (floor) and Austria-Slovakia VTPs (ceiling). The ESP Index moved to a slight premium in Feb - Apr 2020, before the differential widened substantially: in May and June, the ESP Index was at a marked premium, while in September and October it was at a notable discount, before narrowing in November.

Figure 7: ESP Index vs averages of day-ahead and month-ahead European hub prices (EUR/MWh)²⁵



Source: Data from Gazprom Export and Argus, graph by the author

The differentials can be explained by the expansion of ESP sales for delivery schedules other than prompt/BoM and month-1-3 from March 2020 onwards. In the summer of 2020, a substantial proportion of ESP sales were for delivery in winter, and thus held a premium over the prompt and month-ahead products available on the European hubs in the prevailing low-price environment. Conversely, just as prompt and month-ahead hub prices were rising as the European market moved into winter in September-November, the ESP was concluding sales for delivery in summer 2021, with prices discounted accordingly. In other words, the ESP Index was already partially starting to reflect winter pricing in transactions concluded between April and July 2020, putting it at a premium to the day-ahead and month-ahead European hub prices. Conversely, in transactions concluded between September and November, the ESP Index was already partially reflecting summer prices for 2021.

Therefore, the period Feb 2019 - Jan 2020 was the timeframe in which the comparison of the ESP Index with the average of day-ahead and month-ahead prices on European hubs mostly closely represented a 'like-for-like comparison' exercise. Conversely, the period since February 2020, and

²⁵ The six markets covered in this pricing graph (TTF, Gaspool, NCG, Czech VTP, Slovakia VTP, and Austria VTP) account for the overwhelming majority of ESP sales, excluding only Hungary and Italy. To avoid having too many data sets on the graph, these six sets of pricing data have been divided into pairs. These pairs were chosen on the basis of the very narrow differentials between each hub in the pair. Using these pairs, rather than a single price (such as TTF) enables us to see how the ESP Index sat in the corridor between these various hub prices from April to November 2019.

especially between June and October, when no prompt sales were concluded at all, is far from a 'like-for-like' comparison. This logic is proven by the fact that the point at which all three pairs of European hubs converged with the ESP Index (November 2019) was also a month in which virtually all of the sales on the ESP were either prompt, BoM, month-ahead, or month-2/3, making the ESP sales closely comparable with the averages of day-ahead and month-ahead prices on the European hubs.

This points to the important conclusion that, all things being equal, Gazprom Export has, at least in certain months, offered volumes at prices very close to those of the European hubs. So, if the ESP sales are not substantially more profitable than simply offering volumes at hubs, why has Gazprom Export gone to the effort (and expense) of setting up the ESP? Furthermore, why have Gazprom's counterparties decided to buy volumes on the ESP, rather than on European hubs?

8. The power of information

In comparison to selling via the European hubs, the ESP offers an attractive combination of two things to Gazprom Export: information and confidentiality.

On the one hand, the ESP provides Gazprom with valuable (some traders might say priceless) information about the gas needs of its counterparties and the prices they are willing to pay. Given that Gazprom already knows the details of any LTCs it has with its ESP counterparties, and indeed the nominations made by those counterparties, combining the knowledge provided by the LTCs and ESP enables Gazprom to draw well-informed conclusions about its counterparties' trading strategies. The ESP provides information about counterparty gas needs to a greater extent than hubs, because Gazprom Export can view the unsuccessful bids made by its counterparties, in addition to the prices and volumes of concluded sales that would be visible if the sale were taking place on a trading hub.

On the other hand, with its counterparties bound by non-disclosure agreements, Gazprom Export benefits from confidentiality in making non-LTC sales that do not broadcast to the wider trading community the volumes and prices it is willing to offer, as would be the case if it placed substantial volumes on European hubs.²⁶ And those volumes are indeed substantial: as noted earlier, Gazprom Export sold 27.8 bcm via the ESP in the gas year 2019-20. If those substantial volumes were placed on European hubs, there is a strong possibility that they would move the market. By contrast, if Gazprom Export can sell non-LTC gas to its counterparties via the ESP, the pricing impact on the hubs is secondary: it is a ripple effect as counterparties take less from hubs and more from the ESP.

The desire of Gazprom Export not to 'move the market' is understandable, given the size of its LTC portfolio and, within that portfolio, the volume of hub-indexed LTCs for delivery to western and central Europe. Even a small amount of downward pressure on prices generated by placing substantial volumes on European hubs would impact Gazprom Export revenues from hub-indexed LTC sales. As a hypothetical example, if placing those substantial volumes on European hubs (instead of the ESP) caused annual average hub prices to drop by an average drop of 0.10 EUR/MWh (1.25 USD/1,000m³)²⁷, the impact on Gazprom's sales revenues when 60-65 per cent (120-130 bcm) of its reported 200 bcm per year European sales are hub-indexed (or quasi oil-indexed in a pricing corridor narrow enough to be effectively hub-indexed) would be the loss of USD 150.0-162.5 million.

The same logic may also apply from the perspective of Gazprom's counterparties. It is possible that, given the substantial volumes purchased on the ESP, Gazprom's counterparties may prefer to purchase those volumes via the ESP in a bid to avoid the risk of pushing hub prices upwards through an expression of customer demand, especially if those counterparties hold long-term contracts with prices index-linked to those hubs. For Gazprom's counterparties in central Europe, especially in the Czech Republic and Slovakia, the limited liquidity of the national hubs could mean that a series of substantial purchases is likely to influence the prices on those hubs. Indeed, the ESP sales of 3.1 bcm for delivery

²⁶ I am grateful to my colleague, Patrick Heather, for his insights in relation to this point.

²⁷ 0.10 EUR/MWh represents a drop of just 1 per cent on a hub price of 10 EUR/MWh.

to the Czech Republic and 5.3 bcm for delivery to Slovakia in the gas year 2019-20 certainly represent substantial volumes, relative to the sizes of those two national markets.

According to the latest IEA data, net imports to the Czech Republic totalled 8.4 bcm in Sept 2019 - Aug 2020, while for Slovakia that figure was 4.6 bcm. Therefore, if the figures for the gas year (in Oct 2019 - Sept 2020) are assumed to be similar to the figures for September to August, ESP sales equated to over a third of Czech net imports and even reached 115 per cent of Slovak net imports. The figure for Slovakia supports the conclusion that a substantial share of ESP sales for delivery to Slovakia were actually sold on to other destinations, and were most likely placed in Ukrainian storage, having been either offtaken in Ukraine as 'backhaul' (virtual reverse flow) or physically delivered from Slovakia to Ukraine via the Budince cross-border interconnection.^{28 29}

The key point here is that the volumes sold on the ESP for delivery to the Czech Republic and Slovakia in 2019-20 were large relative to the size of the national market, and certainly would have been large enough to have moved prices on the Czech VTP and Slovakia VTP trading platforms, had Gazprom Export simply placed those volumes on those two hubs.

From Gazprom's perspective, a significantly beneficial aspect of the ESP is that it provides a one-way flow of information to Gazprom from its counterparties. It offers Gazprom insights into its counterparties' gas needs and trading strategies, while at the same time offering Gazprom a means of conducting sales transactions that does not broadcast to its counterparties the prices at which it is delivering gas supplies to various markets. In that regard, the flow of information generated by the ESP has substantial value for the crafting of Gazprom's broader European sales strategy.

9. Conclusions

Since its launch just over two years ago, the Electronic Sales Platform has proven to be a useful component in Gazprom's European sales strategy, complementing its portfolio of long-term contracts and the activities of its trading subsidiaries. The sales volumes have been substantial, and the range of products offered has widened. Yet the ESP sales have remained geographically concentrated in four countries (Germany, Austria, Czech Republic, and Slovakia) where Gazprom has long been present. In the periods where the ESP Index has been most comparable to European hubs in terms of products sold, the ESP Index has tracked the hub prices closely, which suggests that Gazprom is offering a competitive set of products to its counterparties.

The value of the ESP appears to be twofold: Firstly, it has operated as a tool of sales optimisation, by offering Gazprom the chance to monetise additional volumes in a rising market, and then 'lock in' forward sales in the supply-long, low-price market of summer 2020. In terms of utilisation of transportation capacity (which Gazprom either owns or has already booked and paid for), the offer of ESP volumes at a discount to LTC prices enables Gazprom to maintain sales (and physical deliveries) at times when its counterparties may find it commercially beneficial to nominate down their offtake to take-or-pay levels on their Gazprom LTCs and seek cheaper alternatives on European hubs. Conversely, when Gazprom's export routes approach full capacity, it may simply decline to offer certain products on the ESP, to avoid over-committing itself in terms of transportation capacity.

Secondly, and in contrast to the conduct of sales optimisation via its subsidiaries trading on hubs, the ESP has provided Gazprom and its counterparties with relative confidentiality in their non-LTC transactions. Volumes may be bought and sold without 'moving the market' directly, while Gazprom also gains access to valuable information about its counterparties' gas needs and pricing inclinations.

²⁸ In Jan – Oct 2020, imports into Ukraine from Slovakia totalled 9.9 bcm, including 6.8 bcm of physical imports and 3.1 bcm of 'backhaul'. A substantial share of this has been injected into storage.

²⁹ TSOUA, 2020. Gas transportation volumes from Europe reached 15 billion cubic meters over 10 months of 2020. *Press Release*, 6 November. <https://tsoua.com/en/news/gas-transportation-volumes-from-europe-reached-15-billion-cubic-meters-over-10-months-of-2020/>

The ESP holds strategic value for Gazprom and is now firmly established as a key instrument in Gazprom's European sales portfolio. As an indicator of Gazprom's broader sales strategy, it has suggested two aspects of that strategy in the past two years. Firstly, Gazprom has been comfortable offering additional volumes via the ESP at a discount to its LTC sales in order to generate additional sales volumes and revenues, within the limits of its export transportation capacity, despite the fact that European gas prices have followed a general pattern of decline in the period since the launch of the ESP (see Figure 7). Secondly, when the European market hit a pricing floor in the summer of 2020, Gazprom was either unwilling or unable to generate prompt sales via the ESP.

Taken together, these two points lead to an overall conclusion. It is possible that Gazprom recognises that, despite being the largest single supplier of gas to the European market, when that market is supply-long (as it has been since 2019) it has pricing power only to the extent that it can push prices down. If Gazprom wished to lift prices by tightening the market, it would have to take such large volumes off the market that it would lose far more than it gained. Equally, the low prices of summer 2020 represented a floor for Gazprom: offering ESP volumes at a discount to European hubs (in order to generate sales in an oversupplied market) would potentially have been cash negative for Gazprom. Therefore, the ESP provides a representation in miniature of Gazprom's broader European sales strategy: a desire to optimise sales between a pricing floor and ceiling, while at the same time being unable to move the market upwards and unwilling to push it down. The key to achieving this optimisation is the ability to offer just enough gas to the market to maximise sales, but just little enough to avoid flooding the market. In that regard, the ESP represents a precise and controlled method of 'fine tuning' Gazprom's European sales, although it is debatable which is more valuable for Gazprom: the financial sales revenues or the flow of market-relevant information.

In the past, less competitive conditions on the European market may have allowed Gazprom to pursue a more rigid sales strategy based on decades-long, oil-indexed LTCs. By contrast, in today's competitive market, the generation of both sales revenues and valuable information mark the ESP as a success in Gazprom's efforts to adapt and become more competitive. The very fact that Gazprom's counterparties have proven more than willing to purchase volumes on the ESP implies that they too regard the ESP as an attractive means of conducting sales transactions with Europe's largest supplier.